BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 01-29
November 26, 2001

TO THE OFFICER IN CHARGE OF SUPERVISION AND APPROPRIATE SUPERVISORY AND EXAMINATION STAFF AT EACH FEDERAL RESERVE BANK AND TO EACH DOMESTIC AND FOREIGN BANKING ORGANIZATION SUPERVISED BY THE FEDERAL RESERVE

SUBJECT: The USA PATRIOT Act and the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001

Background:

On October 26, 2001, the President signed into law H.R. 3162, the USA PATRIOT Act (Act), which contains strong measures to prevent, detect, and prosecute terrorism and international money laundering. Title III of the Act is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. It includes numerous provisions for fighting international money laundering and blocking terrorist access to the U.S. financial system. The Act is far-reaching in scope, covering a broad range of financial activities and institutions.

The provisions affecting banking organizations are generally set forth as amendments to the Bank Secrecy Act (BSA). These provisions relate principally to U.S. banking organizations' relationships with foreign banks and with persons who are resident outside the United States. The Act, which generally applies to insured depository institutions as well as to the U.S. branches and agencies of foreign banks, does not immediately impose any new filing or reporting obligations for banking organizations, but requires certain additional due diligence and recordkeeping practices. Some requirements take effect without the issuance of regulations. Other provisions are to be implemented through regulations that will be promulgated by the U.S. Department of the Treasury, in consultation with the Federal Reserve Board and the other federal financial institutions regulators.

This SR letter briefly describes the provisions of the Act that should receive banking organizations' and Federal Reserve supervisors' immediate attention. The letter also describes new rules that are required to be issued or may be issued by Treasury under the Act. All banking organizations supervised by the Federal Reserve should ensure that their compliance staffs carefully review the Act and prepare to implement its provisions within appropriate timeframes.

At this time, there are several provisions of the Act that will require interpretation by Treasury. This SR letter does not offer any interpretive guidance, but does identify some important areas where additional guidance by Treasury will be required. In this regard, Federal Reserve staff is working closely with Treasury, other federal regulators, financial institutions, and law enforcement in our joint efforts to implement Congressional goals.

Provisions Effective Without Issuance of Regulations

1. Prohibition on U.S. Correspondent Accounts with Shell Banks
   (31 U.S.C. 5318(j); Act section 313)
   Effective Date: December 25, 2001

The Act prohibits covered financial institutions from establishing, maintaining, administering, or managing correspondent accounts with "shell banks," which are foreign banks that have no physical presence in any jurisdiction.[1] An exception, however, permits covered financial institutions to maintain correspondent accounts with shell banks that meet certain criteria. Under the criteria, the shell bank must be affiliated with a depository institution, credit union, or foreign bank that maintains a physical presence in the United States or in another jurisdiction, and the shell bank must be subject to supervision by the banking authority that regulates the affiliated entity.[2]

The Act also provides that covered financial institutions must take "reasonable steps" to ensure that accounts for foreign banks are not used to indirectly provide banking services to shell banks. The Act directs Treasury to issue regulations to further define reasonable steps.

2. Availability of Bank Records
   (31 U.S.C. 5318(k); Act section 319(b))
   Effective Date: December 25, 2001

The Act contains provisions to assist bank regulators and law enforcement authorities in obtaining certain records from covered financial institutions.

Requests from regulators. One provision requires a covered financial institution, upon request of the appropriate federal banking agency, to produce records relating to its anti-money laundering compliance or its customers. Such records must be produced within 120 hours of the request.

Requests from law enforcement. The Act provides that Treasury or the U.S. Attorney General may issue a subpoena or summons to any foreign bank with a correspondent account in the United States and request records relating to that account, including records maintained abroad about deposits into the foreign bank. To facilitate this process, a covered financial institution that has a correspondent account for a foreign bank must maintain in the United States:

a. Records identifying the owners of the foreign bank, and
b. The name and address of a person in the United States who is authorized to accept service of legal process on behalf of the foreign bank. This means that the foreign bank must designate an agent for service of process.

The covered financial institution must produce the records described above in (a) and (b) within seven days of receipt of a written request of a law enforcement officer.

Treasury worked with the banking industry, Federal Reserve staff and other federal regulators, and law enforcement agencies to develop a "certification"

process to assist covered financial institutions to comply with sections 313 and 319(b) of the Act. Treasury publicly released a notice on the certification and related guidelines on November 20, 2001. (See, Treasury's web site at http://www.treas.gov/press/releases/po813.htm.)

Termination of Accounts. Treasury or the U.S. Attorney General may, by written notice, direct a covered financial institution to terminate its relationship with a foreign correspondent bank that has failed to comply with a subpoena or summons or has failed to initiate proceedings to contest a subpoena or summons. If the covered financial institution fails to terminate the correspondent relationship within 10 days of receipt of notice, it could be subject to a civil money penalty of up to $10,000 per day.

3. Due Diligence for Private Banking and Correspondent Accounts
(31 U.S.C. 5318(i); Act section 312)
Effective Date: Regulations to be proposed by April 24, 2002; whether or not regulations are issued, provision is effective on July 23, 2002

General Due Diligence. The Act requires due diligence by all financial institutions that maintain, administer, or manage private banking accounts or correspondent accounts in the United States for non-United States persons.[3] With respect to all such accounts, U.S. institutions must have "appropriate, specific and, where necessary, enhanced due diligence policies, procedures, and controls that are reasonably designed to detect and report instances of money laundering through those accounts." Treasury, in consultation with the Federal Reserve Board and the other federal financial institutions regulators, is directed to issue regulations clarifying this general requirement.

Additional Standards for Certain Correspondent Accounts. The Act requires additional measures for correspondent accounts of foreign banks that either are licensed by particular jurisdictions or operate under offshore banking licenses.[4] The particular jurisdictions specified by the Act are (1) jurisdictions designated by intergovernmental groups (such as the Financial Action Task Force) as non-cooperative with international anti-money laundering standards, and (2) jurisdictions designated by Treasury as warranting special measures due to money laundering concerns.[5]

For correspondent accounts of foreign banks operating under the licenses described above, a U.S. financial institution has the following additional obligations:

- If shares of the correspondent foreign bank are not publicly traded, the U.S. financial institution must take reasonable steps to identify each of the owners of the foreign bank and the nature and extent of each owner's interest.
- The U.S. financial institution must take reasonable steps to conduct enhanced scrutiny of the correspondent account to identify suspicious transactions.
- The U.S. financial institution must take reasonable steps to ascertain whether the correspondent foreign bank has correspondent banking relationships with other foreign banks and, if so, the U.S. financial institution must identify such other banks and conduct general due diligence (as described above) with

respect to them.

The Act does not specify whether this provision applies to all correspondent accounts maintained by such foreign banks or only to certain types of correspondent accounts. The Act sets forth only minimum requirements for the "enhanced scrutiny" required for these accounts, and does not define "reasonable steps." Future Treasury regulations should provide additional guidance.

Private Banking Account Minimum Due Diligence Standards. The Act specifies minimum standards for private banking accounts, defined as accounts with minimum deposits of $1 million that are assigned to or managed by a person who acts as a liaison between a financial institution and the beneficial owner(s). For all private banking accounts maintained by or on behalf of non-United States persons, the financial institution must report suspicious transactions and keep records of: (1) the names of all nominal and beneficial owners, and (2) the source of funds deposited in those accounts.

For any private banking account requested or maintained by or on behalf of a senior political figure or his or her immediate family members or close associates, the financial institution must conduct enhanced scrutiny of the account to detect any transactions that may involve proceeds of foreign corruption. These requirements are in accordance with current Federal Reserve guidance, as set forth in SR letter 01-3, "Guidance on Enhanced Scrutiny for Transactions That May Involve the Proceeds of Foreign Official Corruption." However, Treasury may in the future impose additional or different requirements.

Areas to be Covered by Future Regulatory Action

1. Special Measures" for Certain Jurisdictions, Financial Institutions, International Transactions, and Accounts
   (31 U.S.C. 5318A; Act section 311)
   Effective Date: Determined by future regulation

Treasury has broad regulatory authority to require financial institutions to perform additional recordkeeping and reporting with respect to particular financial institutions operating outside the United States, institutions in particular jurisdictions, types of accounts, and types of transactions, if Treasury determines that such institutions, jurisdictions, accounts, or transactions are of "primary money laundering concern."[6] Treasury must consult with the Federal Reserve Board and other agencies as appropriate in determining whether to impose specific measures. The measures may be imposed by regulation or by order; however, any measure other than a regulation must expire within 120 days.

In general, the types of measures contemplated by this provision are maintenance of records and filing of reports with information about transactions, participants in transactions, and beneficial owners of funds involved in transactions. In addition, special measures could require due diligence with respect to the ownership of payable-through accounts and maintenance of information about correspondent bank customers that have access to correspondent accounts.

The Act requires Treasury, in consultation with other regulators, to issue regulations on the application of the term "account" to non-banks. Treasury is required

to define "beneficial ownership" and other terms used in this section, as appropriate.

2. Standards for Verification of Customer Identification
   (31 U.S.C. 5318(l); Act section 326)
   Effective Date: Regulations to be effective by October 25, 2002

Treasury is required to issue regulations for financial institutions setting forth minimum standards for customer identification at account opening. The regulations will require verification of customer identification, maintenance of records of verification, and comparison of identification with government lists of known or suspected terrorists. For financial institutions engaged in financial activities described in the Bank Holding Company Act, these regulations are to be issued jointly by Treasury and the institutions' federal functional regulators.

3. Government and Financial Institution Information Sharing
   (Act section 314)
   Effective Date: Regulations to be issued by February 23, 2002

Treasury must issue regulations to encourage further cooperation among financial institutions, regulatory authorities, and law enforcement, for the purpose of sharing information about persons and entities engaged in or suspected of terrorist acts or money laundering activities. The regulations may require financial institutions to designate points of contact for information sharing and account monitoring, and to establish procedures for protecting information.

Effective immediately, financial institutions may, after giving notice to Treasury, share among themselves and with financial trade associations information about persons and entities engaged in or suspected of terrorist acts or money laundering activities. The Act provides that such sharing generally will not constitute a privacy violation of the applicable provisions of the Gramm-Leach-Bliley Act.

4. Restrictions on Concentration Accounts
   (31 U.S.C. 5318(h); Act section 325)
   Effective Date: Determined by future regulation

The Act grants Treasury the authority to issue regulations relating to the maintenance and use of concentration accounts (a term not defined in the Act), but Treasury is not required to do so. The purpose of the regulations would be to prevent the use of such accounts to obscure the identity of an individual customer of a financial institution. In general, the regulations would prohibit customer direction of transactions through concentration accounts, prohibit financial institution staff from giving customers any information about the financial institution's concentration accounts, and require written procedures governing documentation of transactions involving concentration accounts.

Suspicious Activity Reporting

1. Clarification of Safe Harbor (31 U.S.C. 5318(g); Act section 351)
   Effective immediately

Current law protects financial institutions from civil liability for reporting

suspicious activity. The Act provides that this protection does not apply if an action against the institution is brought by a government entity.

Current law prohibits financial institutions and their employees from disclosing that a suspicious activity report has been filed. The Act amends current law to prohibit such disclosure by any federal, state, or local government employee, except as necessary to fulfill that employee's official duties.

2. Disclosure in Employment References
(31 U.S.C. 5318(g); 12 U.S.C. 1828(w);
Act sections 351 and 355)
Effective immediately

The Act amends the prohibition on disclosure of suspicious activity reports (SARs) and the safe harbor for liability so that information that has been reported as suspicious may be disclosed by a financial institution in a written employment reference or a written termination notice provided to a self-regulatory agency. However, while the information may be disclosed in these circumstances, the financial institution may not disclose the fact that a SAR was filed.

The Act also amends the Federal Deposit Insurance Act (12 U.S.C. 1828) to provide authority for insured depository institutions and uninsured branches or agencies of foreign banks to disclose suspicions of illegal activity (but not the fact that a SAR was filed) to other such institutions in written employment references for institution-affiliated parties. The Act does not impose any affirmative duty to make such disclosures. This amendment contains the limitation that an institution and its agents may be civilly liable for any disclosure that is "made with malicious intent."

Other Areas Covered by the Act

1. Forfeiture of Funds in U.S. Interbank Accounts
(18 U.S.C. 981(k); Act section 319)
Effective immediately

The Act expands the circumstances under which funds in a U.S. interbank account may be subject to forfeiture.[7] If a deposit of funds in a foreign bank outside of the United States is subject to forfeiture, and the foreign bank maintains an interbank account at a covered financial institution, U.S. law enforcement can seize the funds in the U.S. account as a substitute for the foreign deposit. Law enforcement is not required to trace the funds seized in the United States to the deposit abroad.

2. Anti-Money Laundering Program Requirement
(31 U.S.C. 5318(g); Act section 352)
Effective Date: April 24, 2002

Section 352 of the Act imposes on all financial institutions an anti-money laundering program requirement. The program must include components similar to those found in the Federal Reserve Board's Regulation H requirements at 12 CFR 208.63. Further guidance will be issued in the event that future Treasury regulations result in any change in the application of Regulation H to banking

organizations supervised by the Federal Reserve.

3. Filing of SARs by Securities Brokers and Dealers
   (Act section 356)
   Effective Date: Determined by future regulation

Section 356 of the Act requires Treasury, in consultation with the Federal Reserve Board and the Securities and Exchange Commission, to issue regulations requiring registered securities brokers and dealers to file SARs. These regulations are to be published in preliminary form by January 1, 2002, and in final form by July 1, 2002.

4. Penalties (31 U.S.C. 5321, 5322, 5324; Act sections 353 and 363)
   Effective for future violations

The Act amends the BSA to authorize Treasury to impose penalties of up to $1 million for violations of new 5318(i) (due diligence for private banking and correspondent accounts) and new 5318(j) (accounts with shell banks). The Act also provides for civil and criminal penalties for violations of geographic targeting orders issued by Treasury.

5. Secure Filing Network (Act section 362)
   Effective Date: Network to be operational by July 23, 2002

The Act directs Treasury to establish within its Financial Crimes Enforcement Network a highly secure electronic network through which reports (including SARs) may be filed and information regarding suspicious activities warranting immediate and enhanced scrutiny may be provided to financial institutions.

6. Anti-Money Laundering Record Considered in Applications
   (12 U.S.C. 1828(c) and 1842(c); Act section 327)
   Effective for applications submitted after December 31, 2001[8]

The Act amends the Bank Holding Company Act and the Federal Deposit Insurance Act to require that, with respect to any application submitted under the applicable provisions of those laws, the Federal Reserve Board and the other federal banking regulators must take into consideration the effectiveness of the applicants' anti-money laundering activities, including in overseas branches.

7. Efficient Use of Cash Transaction Reports (Act section 366)
   Report required by October 25, 2002

The Act directs Treasury to review the cash transaction reporting system to make it more efficient, possibly by expanding the use of exemptions to reduce the volume of reports.

Sunset Provision

The Act includes a mechanism for expedited repeal of the Act if Congress in the future determines that the provisions of the Act are no longer necessary. After September 30, 2004, Congress may terminate the effect of all provisions of the Act, and

any regulations promulgated thereunder, by enacting a joint resolution to that effect.

Reserve Banks are asked to distribute this letter to banking organizations in their districts that they supervise and to supervisory staff. Questions may be addressed to Carmina Hughes, Special Counsel, (202) 452-5235; Pamela Johnson, Senior Anti-Money Laundering Coordinator, (202) 728-5829; Nina Nichols, Senior Attorney, (202) 452-2961; Ann Misback, Assistant General Counsel, (202) 452-3788; or Janet Crossen, Senior Counsel, (202) 452-3281.

Richard Spillenkothen
Director

Cross Reference: SR letter 01-3
cc: General Counsel at each Federal Reserve Bank

Note:

1. Some of the BSA-related provisions in the Act apply only to "covered financial institutions," which are defined as institutions listed in 31 U.S.C. 5312(a)(2)(A) through (G). These are: insured banks under 12 U.S.C. 1813(h); commercial banks or trust companies; private bankers; agencies or branches of foreign banks in the United States; insured institutions under 12 U.S.C. 1724(a); thrift institutions; and brokers or dealers registered under the Securities Exchange Act of 1934. Other provisions in the Act apply to all financial institutions, which includes covered financial institutions and other entities such as money services businesses (for example, check cashers and currency exchanges); investment bankers or investment companies; credit card systems; casinos; insurance companies; and any other business so designated by Treasury.
2. The Act defines an "affiliate" as a foreign bank that is controlled by or under common control with another institution. A bank has a "physical presence" in a jurisdiction if it maintains a place of business at a fixed address (other than a solely electronic address), employs full-time staff, maintains operating records, and is subject to inspection by the bank's licensing authority.
3. The BSA and applicable regulations define "person" expansively to include any individual, corporation, partnership, trust or estate, joint stock company, association, syndicate, joint venture or other unincorporated organization or group, Indian Tribes, and all entities cognizable as legal personalities. "United States" is defined to include the States, the District of Columbia, Indian lands, and the Territories and Insular Possessions of the United States. "Non-United States Person" generally means an individual resident outside the United States (even if a U.S. citizen) or an entity that is located outside the United States.

4. An offshore banking license is defined as a license to conduct banking activities, where a condition of the license is that the bank may not offer banking services to citizens of, or in the local currency of, the jurisdiction issuing the license.
5. For designations by intergovernmental groups, the United States must be a member of the group, and the U.S. representative must concur in the designation. For designations made by Treasury, the designation must be made in accordance with section 311 of the Act, as described later in this SR letter.
6. The Act provides that Treasury in consultation with the Department of State and the U.S. Attorney General may make determinations as to whether particular institutions, types of accounts, classes of transactions, or foreign jurisdictions are of primary money laundering concern.
7. The Act uses the definition of "interbank account" in 18 U.S.C. 984(c)(2)(B), "an account held by one financial institution at another financial institution primarily for the purpose of facilitating customer transactions."
8. There is a question whether this provision applies to applications submitted after December 31, 2000 (including applications now pending), or to applications submitted after December 31, 2001. Clarification of that point is being sought.